

***Sheep Creek Water Company***  
***4200 Sunnyslope Rd.***  
***P.O. Box 291820***  
***Phelan, CA 92329-1820***  
*Office (760) 868-3755/Fax (760) 868-2174*  
*Email [sheepcreek@verizon.net](mailto:sheepcreek@verizon.net) / [www.sheepcreekwater.com](http://www.sheepcreekwater.com)*

June 18, 2019

Phelan Pinon Hills Community Services District  
Attn: General Manager Don Bartz  
P.O. Box 294049  
Phelan, CA 92329

Re: Sheep Creek Water Company Consolidation Plan

Ladies and Gentlemen:

The State Water Resources Control Board (SWRCB) has ordered the evaluation of alternative methods to resolve the water supply shortage experienced by Sheep Creek Water Company (SCWC). One alternative requires SCWC to drill four new wells within four years, in order to increase its supply. The second alternative involves the consolidation of SCWC with Phelan Pinon Hills Community Service District (PPHCSD).

SCWC has constituted a Consolidation Committee ("SCWC Committee") as requested by PPHCSD at its Special Engineering Committee meeting on April 29, 2019. The SCWC Committee has obtained valuation information and developed a preliminary plan for the potential consolidation of SCWC with PPHCSD. This letter presents the general terms and conditions for the potential consolidation of SCWC with PPHCSD, with the oversight and financial assistance of the SWRCB.

The option to be chosen remains subject to evaluation and approval by the Board of Directors of PPHCSD and the Board of Directors and Shareholders of SCWC. Consistent with PPHCSD's request, this letter proposes terms for acquisition by PPHCSD of SCWC's assets.

In order to determine the value of SCWC's assets, SCWC requested that its legal counsel recommend three professional firms with the expertise to appraise the assets of SCWC. Andrew J. Johnson of The Valuation Source Company was selected to perform the appraisal. Based on his report, SCWC has been valued at Twenty-Three Million Seven Hundred Twenty Thousand Dollars (\$23,720,000). A copy of Mr. Johnson's complete appraisal report is attached.

### **Value of Sheep Creek Water Company:**

The summarized, appraised, fair market value of the assets as of April 8, 2019, is as follows:

- \$13,030,000 - 2,895.87 Acre-Feet of Water Rights
  - \$6,790,000 - Mains, Hydrants, Regulators, Meters, Piping, & Related Infrastructure
  - \$2,390,000 - 4200 Sunnyslope Rd – real estate improved with an office, shop, storage yard, and two tanks
  - \$730,000 - 6666 Hwy 2 – real estate improved with five wells and two tanks
  - \$330,000 - Tanks 3 & 6 located on easements
  - \$250,000 - Vehicles, Equipment, & Other Personal Property
  - \$60,000 - 7788 Serrano Rd – unimproved real estate
  - \$55,000 - 4625 Walnut Rd – real estate improved with a well
  - \$80,000 - 263rd St – real estate improved with an injection/extraction well not presently in operation
- 
- \$23,720,000 - TOTAL (rounded to the nearest \$10,000)

### **Potential Benefits to PPHCSD:**

As SCWC reviews the State of California’s request to consider consolidating SCWC with PPHCSD, the SCWC Committee has identified these potential benefits for PPHCSD:

- PPHCSD would acquire approximately 2,900 acre-feet of water rights, including those water rights permitted by the Division of Water Rights of the State Water Resources Control Board under Application ID Z000718 (certified June 12, 1917) and licensed by San Bernardino County under license issued September 9, 1918, and those adjudicated rights established in the case of *Pacific Southwest Trust & Savings Bank, et al. v Sheep Creek Water Company*, RCSC Case No. 15583 from Sheep Creek; none of which would be subject to the Antelope Valley Adjudication and most of which would not be subject to the Mojave Basin Adjudication.
- Water from the Wrightwood Well Field into Phelan is 100% gravity flow.
- Water from the Wrightwood Well Field is a potential water source which could be used to blend with PPHCSD water to mitigate its present Chromium 6 levels.
- Hydroelectric power generation is possible, utilizing the gravity flow of water within the SCWC system.
- SCWC’s Tunnel source requires no pumping costs.
- SCWC’s Well 11 is located within the Alto Sub-basin where PPHCSD already owns water rights.

- SCWC has storage capacity of 6.1 million gallons of water for approximately 1200 users.
- SCWC owns numerous pieces of equipment used for the operation and installation of SCWC facilities, including a recently purchased skip loader and service vehicles.
- SCWC 40-acre parcel in the canyon may be used for income-producing recreational amenities such as an equestrian, park, and other community activities.
- SCWC's 5-acre parcel, which includes three storage tanks, office space, a shop, and a storage yard, is located near the PPHCSD office.
- SCWC employees have decades of collective experience, and vast knowledge of the SCWC system and their continued employment will greatly benefit PPHCSD in its operation of the system.
- PPHCSD would gain a significantly larger service area, including additional commercial property access as well as residential customers.

#### **Financial Considerations:**

The following sources of funding and financial factors should assist PPHCSD to acquire the assets of SCWC at fair market value, in order to complete a consolidation:

- Up to \$5,000,000 consolidation grant available from the State.
- Additional State and Federal grants and other funding that may be available for consolidation purposes.
- Zero or low-interest loans to PPHCSD.
- Bonded indebtedness against existing PPHCSD customers.
- Increased PPHCSD customer rates, generating additional monthly income, both residential and commercial.
- Reduced cost of water to water users when using water from the Wrightwood Well Field.

#### **Consolidation Process:**

- The purchase price will be negotiated between SCWC and PPHCSD, based on appraisal-established fair market value. The cost of each party's appraisal shall be paid for by the party securing the appraisal.
- SCWC would pay off all outstanding loans and other financial obligations; currently, SCWC owes approximately \$600,000.00.
- Further, in 2018, The California Rural Water Association's engineering report commissioned by SCWC indicated that SCWC would benefit from a number of improvements, several of which would need to be completed to integrate the two water systems, including the construction of an additional well, replacement of

some water meters, and the removal of dead-end lines with the installation of fire hydrants. These necessary improvements could either be completed through a consolidation grant of up to \$5 million from the State, or a reduction in the purchase price, subject to recognition of facilities condition already taken into account in the appraisals, in arriving at fair market value. Currently, SCWC water users are paying for ongoing maintenance and certain upgrade projects through their existing water rates, which payments further reduce the overall estimated cost of any required improvements.

- The agreed upon net fair market value of SCWC will be established as the price for consolidation. The net price will be divided by the 8000 shares of SCWC, with each shareholder being compensated for his/her/its shares at the per share value established.
- PPHCSD shall hire all SCWC employees as permanent employees, in positions, at salaries, and with benefits comparable to existing PPHCSD employees having comparable knowledge, skills, and experience. SCWC employees have extensive knowledge of the SCWC system and will be critical to PPHCSD providing reliable water service to SCWC's customers following any consolidation.

**Conclusion:**

The Board of Directors of SCWC considers this to be a viable proposal for the consolidation of SCWC with PPHCSD. The proposal remains entirely subject to negotiation, and then approval votes by both Boards of Directors and by SCWC Shareholders. SCWC's Board invites PPHCSD to respond with its comments.

Respectfully Submitted,

Sheep Creek Water Company



Andy Zody  
President

CC: Sean F. McCarthy SWRCB-DDW Chief, South Coast Division  
Eric J Zuniga SWRCB-DDW District Engineer  
Hector Cazares SWRCB-DDW  
Caitlin Juarez SWRCB-DDW Consolidation Coordinator  
Ernest E. Riffenburgh, Esq., General Counsel, SCWC